Executive Summary

1. Background and Objectives

Economists have long recognized the gains from international trade. If might be fair to say that most, if not all, economists believe that globalization and economic growth are intimately related and, furthermore, that globalization has brought enormous benefits for many countries and people.

The current state of our knowledge, as well as the past diverse experiences of countries, suggest that there are still many questions, old and new, that need to be explored in order to improve our understanding of various aspects of the globalization that we are facing today, including its causes and consequences. This research project contributes to the literature by an attempt to answer some of these questions.

Most of these questions are related to the relationship between globalization on the one hand, and growth, productivity, reallocation, location of industries and firms, employment and wage inequality, market structure, etc. on the other. Developing answers to these questions is likely to be a pivotal step toward maximizing the potential benefits from globalization, as well as sharing those benefits more widely not only across countries but also across various economic agents in a country. All papers contained in this report tackle some of the questions raised above.

One of the key features of this report- micro data analysis of globalization -stems from the recognition that many of the old and new issues raised above can be addressed better by utilizing micro datasets. We also expect that micro data analysis can potentially give us much richer information on various issues of globalization, such as the exact channels through which the benefits of trade materialize the possible differential effects of trade and investment liberalization, and the existence of factors or policies that are complementary to trade and investment liberalization.

2. Key Findings and Conclusion

Some key findings and conclusions from the chapters in this report are the presented below.

Learning from the experience of Japanese FDI to developing countries, reduction in trade costs between host and home countries has different impacts on the type of foreign direct investment (FDI), and the nature of international production process leads to firms to adopt vertical FDI more than the traditionally horizontal FDI.

Trade liberalization contributes to higher growth of variety in the import of intermediate inputs which has a favorable impact on productivity growth. Moreover, trade liberalization also motives higher frequency of product switching, defined as simultaneously adding and dropping products, and this evidently improves firm efficiency. All these are the lesson from the Korean experience in the 1990s.

Three studies in this project, which elaborates the case study of the Philippines, Vietnamese, and Indian manufacturing, confirm that trade and investment liberalization leads to productivity gains. The Vietnamese study shows that the high firm entry rate in early 2000s increases industry-level productivity, while the Philippines study establishes a relationship that high effective rate of protection reduces productivity growth of some groups of firms. Productivity improvement is also observed in the Indian study. The Vietnamese study further shows that gain in productivity does not only occur at industry level, but also at firm level.

The Indian study further suggests that importance of imported goods in improving productivity suggests that firms are learning from imported and more advanced technology. This is important to note, since positive productivity gains seem to have accrued due to liberalization of the imports of intermediate inputs and capital goods.

The study that utilizes the Malaysian innovation survey finds a rather weak link between exporting and productivity in Malaysian manufacturing. Productivity is driven by capital intensity and human capital but this may not necessarily translate into export dynamism. Innovation, whether it is product or process innovation, is likely to be the key driver in exporting.

There is more evidence for the literature on the positive impact of multinationals operation in a country. Another study on the Vietnamese manufacturing reveals evidence on the existence of productivity spillovers from the presence of multinationals. It is indicated that the magnitude of the spillover effect is large for the Vietnamese case. The study nonetheless finds that the potential for the spillover effect is limited by the substantial technology and factor intensity gap between the multinationals and domestic firms.

One of the Thai country papers in this project examines the hypothesis of using imports as a market discipline mechanism. Utilizing data from the Thai manufacturing census, the study finds that that while imports have the potential to act as a market discipline, the effect on the price-cost margin appears to be different between two categories of imports. It is the importation of parts and components instead of final goods that acts as a market discipline.

Learning from the experience of China, a study in this project finds that exporters tend employ more unskilled labor than non-exporters. This is true for both Chinese exporters in the ordinary trade regime and foreign-invested exporting firms in the processing trade regime. The study further finds that that FDI is associated with a higher share of skilled labor in total employment, which supports the Feenstra-Hanson theory of outsourcing.

The study that utilizes the Indonesian manufacturing plant data observes the source of output, employment, and productivity over period 1990-2006 which comprises the sub period of before, during, and post the Asian 1997/98 crisis. The study finds that high output growth during the pre-crisis period was driven significantly by the existing firms. The trend, however, reversed in the 1996-2000 period where the source of manufacturing output growth came from new entrants. Exporting firms consistently provide more jobs than non-exporting firms, and interestingly, prior to the crisis, non-FDI firms created many more jobs compared with FDI firms. The position was reversed post-crisis with FDI firms creating more jobs than non-FDI.

The other Thai paper in this project addresses the migration issue as a form of structural adjustment process coming out as an impact of the globalization process. The empirical investigation is based on in-depth interviews with fifty firms in the industry during November 2009 and February 2010.

This study finds that not all firms opt to hire unskilled foreign workers. There are systematic differences in firm characteristics between firms who hire foreign workers and those who do not. The latter are relatively large in size (both in employment and sales), perform better, and actively undertake upgrading activities. The former are struggling to maintain their profit margins, are relatively small, and do not invest sufficiently in upgrading activities. Interestingly, hiring foreign workers is not their first response, but is a reflection of the fact that firms have yet to successfully undertake functional upgrading. Firms which are late to undertake functional upgrading are likely to hire foreign workers during their structural adjustment process. Allowing the migration of unskilled foreign workers on a temporary basis would be a win-win-win solution for labor importing and exporting countries, as well as for the migrants themselves. Nevertheless, as a condition for allowing firms to hire unskilled foreign workers, government must guard against any retarding effect on the firms' upgrading efforts.

3. Policy Implications

Some policy implications can be drawn from the findings and conclusion of all studies conducted in this project. These are summarized below.

First, trade and investment liberalization is not only a policy to raise static consumer welfare, but also a policy that promotes growth. Trade may not be a sufficient condition for strong, sustained growth, but it is a necessary one. There is pervasive evidence across the studies in this project that trade and/or investment liberalization had a positive dynamic effect on the aggregate economy studied.

Second, trade and investment liberalization should be pursued as part of a broad national growth strategy. In order to enhance the beneficial effects from trade and investment liberalization, other complementary policy ingredients seem necessary. Most studies in this project find the existence of factors—national, industry, and firm characteristics or policies—that affect the relationship between trade/investment liberalization and productivity improvement and growth.

Third, enhancing the absorptive capacity, or human capital, of domestic workers and firms might be necessary in order to gain the potential benefits from international knowledge spillovers: i.e., the advantage of backwardness. As in the study of Vietnamese manufacturing, the degree of FDI spillover is found to be positively affected by measures of the absorptive capacity of domestic firms.

Fourth, trade cost reduction should be on the policy agenda at a high priority for countries that have yet to join the international production networks. In particular, improving trade-related infrastructure is likely to be an important ingredient of policy.

Not all countries benefit from the formation of international production networks. In many developing countries, transport cost remains a key bottleneck. Lack of transport infrastructure will raise transport cost and make markets isolated. Markets that are isolated may also feature little competition, and this will worsen within-country poverty and distribution issues.

Fifth, enhancing the credibility of trade and investment reform is likely to raise the effectiveness of trade/investment liberalization. Pursuing trade and investment liberalization as part of a broad growth strategy, including other non-reversible policies, is likely to be one such strategy.

Finally, policy measures are necessary to ease the burdens of economic agents who have to make adjustments or who are on the losing side of change. This will be particularly the case when the trade or FDI involved is outsourcing-related.